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SUBJECT: Housing in Egypt- Construction Everywhere but No Place to Live

1. (U) Key Points

-- The housing market in Egypt is marked by extreme contradiction. In recent years, the country has witnessed an unparalleled building boom alongside an extreme housing shortage for the poor and the middle class.

-- Prices for high end housing for the wealthiest five percent of the population have skyrocketed in the last few years, fuelled, in part, by oil-rich Gulf investors. Oversupply and the economic slowdown will likely deflate the high-end housing bubble.

-- There remains a chronic housing shortage for low and middle-income buyers. With an estimated four million unit shortfall, Cairo residents have increasingly turned to informal housing solutions which are dangerous and unregulated.

-- The GOE's response to the housing crisis, the National Housing Program, has provided some subsidized housing units to the poor, but far fewer than are needed and often in unattractive locations.

-- Cairo's outdated rent control laws and underdeveloped mortgage market have contributed to the dearth of options for middle income renters and homebuyers.

-- Despite government incentives, private sector builders have been reluctant to build for lower income buyers, opting instead to continue developing high-margin housing for the wealthy.

2. (SBU) Comment: In addition to basic requirements for shelter, the ongoing lack of affordable housing is having profound social impact as well. In Egypt, providing a home is a pre-requisite for marriage and with housing priced well out of reach for many would-be grooms, marriages are being put off by years, and many single Egyptians continue living in their parents' homes into their 30's.

3. (SBU) The GOE's insufficient responses to the ongoing housing crisis have also led to myriad informal and often unsafe housing solutions. The GOE's national housing program is a good start at addressing the crisis, but its progress has been halting and insufficient. Problems in zoning, rent-control, and mortgage-law alongside rampant corruption and government inefficiency have made the translation of "need" into market demand extremely difficult. As result, the private sector has been unwilling or unable to be a significant part of the solution. As with many issues in Egypt, reform in the sector will have to be driven by the government. Such reform won't be easy, and it is unclear if the GOE has the political will and capital to do so.

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Lots of Villas, Not Enough Basic Housing  
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¶4. (U) The housing market in Egypt is marked by contradictions and extremes. Throughout Cairo and into the new communities on its outskirts, there seems no end to residential construction. Billions of dollars have been poured into real estate both from oil-rich Gulf investors as well as an ever growing wealthy class of Egyptians. Egypt's economy has been growing rapidly in the past several years, and with a population of 80 million people, the construction/housing industry has boomed. There is very little room to build anywhere in Cairo's center, so the only choice is to build in the periphery. At the same time, there is a critical shortage of middle and low-income housing units, with an estimated deficit of 4 million units. Informal housing, which has long been an alternative solution for many poor Egyptians, has become the norm. This cable explores the current housing situation in Egypt and examines some of the Egyptian government's responses to what can only be described as a worsening situation.

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Is the High-End Bubble About to Burst?  
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¶5. (U) What is generally referred to as the real estate "market" in Egypt consists almost solely of the high end real estate market. This market caters to a small fraction -- only about five percent -- of the population. Middle and low-income housing are not attractive or as profitable to developers, and they have been reluctant to address those segments.

¶6. (U) Since 2005, the Egyptian economy has been growing at seven percent per year; rising incomes and rising domestic demand have fueled higher inflation; and housing prices have more than doubled. Developers have viewed new real estate projects as an excellent way to make a good return. Egypt has also experienced a flood of foreign investment, much of it from the Gulf, in real estate which has driven up prices for both new and existing housing in the high-end segment. As developers have sought to provide units for Egypt's elite, excess liquidity along with what some analysts describe as a price speculation has created a very large oversupply of high end units. Analysts estimate the supply of high-end homes coming on the market at 40,000 units per year while demand represents about 15,000 units per year. As Egypt experiences slower growth in 2009 (the most optimistic estimates for growth are 3-4%, compared with 7-8% range in the last three years), this oversupply phenomenon may become more acute.

¶7. (U) The market has also witnessed the peculiar phenomenon that prices have gone up along with supply. Real estate models based on rental yields and interest rates imply that prices are in some cases almost four times above reasonable market value. Rental yields are generally between 3-7% of property value, which is far below interest rates (11-13%) and inflation (20%+). Cash liquidity rather than demand thus appears to be fueling the market.

¶8. (U) In addition to speculative pressure, there are various explanations for the large rises in high-end real estate in Cairo. Some of the cost increase can be attributed to the rising cost of land. Government land sold at auction has more than doubled over the past three years. Higher raw materials prices early in 2008 also impacted prices. As raw materials prices fall, developers tend to expand margins rather than lower prices.

¶9. (U) The GOE and many developers continue to insist that the housing market is in fine shape. In November 2008, Housing Minister Ahmed El-Magraby, gave an upbeat assessment of the real estate sector, saying that the Egyptian market was not facing a "free fall." According to Magraby, real estate demand in Egypt -- as opposed to other markets -- is not "speculative." Most buyers pay cash for real estate and hence do not access the credit market. Real estate developers, he added, are well-financed, maintain low inventories, and have no pressure to liquidate assets. He also claimed that Egyptians have a certain "mentality" which prevents them from selling at a price lower than they desire. This uniquely Egyptian attitude, says Magraby, will lead people to take their property off the market rather than sell at a reduced price.

¶10. (U) The behavior of the market tells a slightly different story. Most of the high-end real estate in Egypt is sold "off plan" (that is, before it is built) so much of current construction has been

prepaid. Truly new development is very clearly slowing. Though Egyptian developers have by and large left their official selling prices unchanged as the market has slowed, analysts report that not only have unofficial (actual sales) prices dropped 15-20% but also that the sales of new units have stalled. The Egyptian stock market doesn't appear to share Maghraby's optimism either. The share prices on the Cairo stock exchange of the major Egyptian developers and construction companies are all down between 60-90% in the last 12 months. (Note: To put this into perspective, the overall Egyptian index fell by 56% in 2008.)

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How the Other Half (ok, 95%) Lives  
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¶11. (U) The explosion in housing supply has yet to impact the vast majority of the Egyptian population. While estimates vary, many experts point to a four million unit shortfall and demand for an additional five million units is expected over the next ten years. Other data tends to support this argument. Sixty-five percent of the housing supply is informal, and millions live in slum areas. The owner occupancy ratio in Egypt (percentage of people who own their homes) stands at 32%, the lowest in the world according to Suha Najjar, the Director of Research at Pharos Holdings, a Cairo-based investment bank.

¶12. (U) There is huge, real demand for housing, with almost a complete lack of available units. The existing housing stock is both insufficient and inadequate to serve the needs of the populace. This is further exacerbated by the GOE inability to address the issue and an underdeveloped mortgage market. The government has undertaken efforts to try to stimulate the mortgage market here, but efforts are still in their infancy.

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Vacant Housing in the Midst of an Acute Shortage  
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¶13. (U) Egypt is unique in that, in the midst of an overall acute housing shortage, it has an extraordinarily high level of vacant housing units. According to some estimates, between 20-30% of apartments and housing units in urban areas stand empty. According to USAID and World Bank statistics, nearly 4 million existing urban housing units are vacant and 42% of greater Cairo's housing stock is frozen under rent control.

¶14. (U) This phenomenon is the result of several factors. Real estate has traditionally been one of the few avenues for investment in what for many years was a centrally planned economy. As a low risk, inflation-resistant investment vehicle, families looked to real estate as a way to garner capital gains and often to provide housing for children and grandchildren. At the same time, Egypt has very strong tenant protection laws, with courts that are unwilling to evict delinquent tenants, and an expansive rent-control regime. As a result, the risks of using real estate as an income producing vehicle far outweigh the costs of maintaining units vacant.

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The National Housing Program  
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¶15. (U) In 2005, in response to the growing crisis, the GOE launched the National Housing Program (NHP) with the goal of providing 500,000 highly -subsidized affordable housing units by 2011 for low income buyers. Since then, the government has shifted its target somewhat to providing 500,000 "housing solutions" -- a subtle shift that allows the GOE to broaden its offerings under the NHP to include rental units as well as self-build solutions.

¶16. (U) Under the NHP, the basic unit of housing costs LE 50,000 (US\$9090) to construct. The National Housing Program provides for a LE 15,000 (US\$2727) payment directly to the developer which is dispersed in three parts: one-third at the start of construction, another third when the roof is built, and the final third when the whole house is complete. The purchaser then makes a down payment of LE 5000 (US\$909) and finances the remainder with monthly installment payments over 20 years. The monthly payment starts at LE 160 (US\$29) in year one and increases each year. In addition to the

cash subsidy, the government makes a large contribution to infrastructure and provides heavily discounted land.

¶17. (U) The GOE has also put significant resources behind the "build your own" housing scheme. According to figures released in December 2008 by the Ministry of Housing and Utilities, as of October 2008, 30,000 plots of land had been delivered to beneficiaries in 18 new cities. According to the ministry, the lots all had access to utilities and 14,000 of the beneficiaries had been granted construction licenses. This system is not without its critics, who argue that it encourages construction of informal and unsafe housing; the GOE does not have an effective building inspection system. The "build your own" housing program has also been plagued by accusations of corruption and allegations that the government is slow in providing promised utilities to the areas.

¶18. (U) Housing Minister Magraby has said that the GOE is doing its part by investing LE 15 billion (US\$2.7 billion) in infrastructure (roads, housing, railroads, water and waste water). In a November 2008 speech, he encouraged further private sector investment to prevent a more severe economic downturn. With regards to low-income housing, Magreby said he hated all monopolies, including the government's monopoly on building low-income housing. He claimed to have signed agreements over the past year to provide 250,000 "small units," a huge increase over the pre-2004 number of 35,000 per year. The government looks out for the people, he insisted, though no one can create paradise: "I wish we could give every Egyptian a free house and swimming pool." Maghreby said that his goal in the real estate sector is for Egyptians to be able to get a fair price in an open market.

¶19. (U) Another strong criticism of the GOE's housing initiatives is that it doesn't build housing where people want to live. The GOE has by and large, focused its efforts on building housing far from Cairo and far from places of employment and schools. This, coupled with shoddy transportation and utility infrastructure (if any is provided at all) has made many of the "new cities" intensely unattractive to the intended beneficiaries and contributed to terrible traffic conditions. Even when faced with imminent danger, such as in the case of the rockslide-prone areas of Muqattam in Cairo, families are extremely reluctant to move and be faced with 1-2 hour commutes in stand-still traffic on poor public transport.

#### ----- Egypt's Underdeveloped Mortgage Industry -----

¶20. (U) The Egyptian government passed a mortgage finance law in ¶2001. At first there was little activity in the sector and by mid-2005 total mortgage debt in Egypt amounted to a paltry LE 16 million (US\$2.74 million). The past few years have seen much greater growth, and by the end of the first quarter of 2008, there were LE 2.2 billion (US\$400 million) in outstanding mortgage obligations. This number is still low for a country of the size of Egypt, amounting to only .26% of GDP (as compared to 17% in a country like Malaysia or 50% in the US).

¶21. (U) The creation of the Mortgage Finance Authority, several mortgage finance companies, and a refinance company has contributed to the rise in mortgages from near zero to a 3-4 billion LE. The growth of mortgage finance in Egypt is hampered by several factors: Egyptians traditionally have always wanted to own their homes outright. It is expected that within a new couple, the husband's family is expected to procure the home (outright), and the bride's family is expected to outfit it. While this trend is slowly changing, it is engrained in many. Long-term financing is largely unavailable, with ten years being the maximum available term. Interest rates of 11-13% also make financing unattractive for many buyers. In addition, the legal and regulatory framework remains weak with property registration remaining troublesome and a limited history of courts willing to foreclose on non-performing loans. With improved awareness, appropriate supply, and more attractive interest rates, some real estate experts speculate that mortgage demand could be as high as LE 40 billion (US\$7.3 billion) -- more than 10 times greater than the current mortgage market.

#### ----- The Private Sector

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¶22. (U) As mentioned earlier, private sector activity in the real estate sector has exploded in recent years, but is almost exclusively concentrated on high-end development. Until recently, such development has been so profitable that there has been little movement by private sector developers to build for middle and low-income segments. Speaking to an industry gathering, the private sector attitude was summed up by Sherif Raafat, the Vice Chairman of Concord International Investments, a large Egyptian fund management company, who when asked about the chronic housing shortage for middle and lower class Egyptians, responded that "social housing is the responsibility of the government -- not the private sector." Few of the gathered disagreed.

¶23. (U) One private sector company that is building low-income housing is Orascom Housing Communities (OHC), a subsidiary of the Orascom Group-Egypt's largest multinational corporation. OHC is building a community consisting of 50,000 low income units in 6th of October City, a suburb located about 20 miles from central Cairo. The units are available to buyers who make no more than LE2500 (US\$455) per month and range in price from LE 65,000 to 100,000 (US\$11,820 to \$18,182). Hala Bassiouini, Chairwoman of the Egyptian Housing Finance Company, one of the largest new mortgage finance companies, noted recently that developers are starting to understand that they are overbuilding for the high end clients and are moving to the mid-range clients. She cited the Orascom project as an example of a thoughtfully designed housing solution which she thinks will cater to middle-income clients. She noted that developers are simply going to have to accept lower margins of return, but argues they can still make money serving middle income clientele.

¶24. (SBU) Omar El Hitamy, OHC's Managing Director, told us that the project is profit driven and that OHC could produce low-income housing in a profitable way. OHC's strategy is to produce large volumes of housing units quickly and efficiently. The project, El Hitamy told us, is based on a model pioneered by Homex, the largest home builder in Mexico, and supported by the Mexican government's INFONAVIT national housing fund which provides financing for low-income borrowers funded through the Mexican payroll tax. The first phase of OHC construction consists of 12,000 units. 7,000 have been completed and 4,000 of those have already been sold. In addition to the housing units, OHC has built schools and a "town square" with shops, restaurants, and entertainment facilities. If the Orascom project can succeed, it will be one of the first such satellite cities to do so, as others have foundered because of lack of necessary services and public transport.

¶25. (SBU) An important part of OHC's strategy seems to be to minimize GOE involvement. By pledging to build low-income housing, OHC was able to obtain its land from the government at a rate far below market price. The government is also responsible for providing utilities and schools. In a recent visit to the OHC site, El Hitamy us that OHC has chosen not to rely on much GOE assistance, since the government lacks the competence and speed required for a successful project. OHC has built all of the infrastructure and utilities in the community and is implementing a zero-waste recycling program that Orascom had developed in its other high-end housing projects. El Hitamy told us that the GOE was unable to meet its obligations to build and staff a school, and as a result OHC built, staffed, and runs the school as well.

¶26. (SBU) OHC has faced some difficulty in achieving a critical mass of residents. El Hitamy shared his frustration with the fact that of the 4000 units sold, less than ten percent were currently occupied. This low occupancy rate comes despite the fact that 90 percent of the units have been financed, and buyers are making mortgage payments on empty houses. This might be due to the fact that some purchases may have been speculative, despite government controls on buyer eligibility. Another possibility, El Hitamy said, was that people were disinclined to relocate in the middle of the school year. Despite his frustrations, El Hitamy told us that OHC was confident the project would be a success and would ultimately be profitable. He said that the need for low-income housing was huge, but that Egyptian mortgage financing for low-income borrowers needed to be improved. GOE restrictions on interest rates and payment-to-income ratios meant that very large down payments of LE10-20,000 (US\$1800-3600) were required, and these were beyond the

reach of many would-be borrowers.  
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